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UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

In re:

THE RHODES COMPANIES, LLC, aka

“Rhodes Homes, et al.,¹

Debtors.

Case No.: BK-S-09-14814-LBR
(Jointly Administered)

Chapter 11

**PRE-TRIAL BRIEF OF THE
REORGANIZED DEBTORS**

Affects:

☐ All Debtors

☒ Affects the following Debtor(s):

Bravo, Inc. 09-14825

Trial Date: March 5, 2012

Trial Time: 9:30 a.m.

Courtroom 1

¹ The Debtors in these cases, along with their case numbers are: Heritage Land Company, LLC (Case No. 09-14778); The Rhodes Companies, LLC (Case No. 09-14814); Tribes Holdings, LLC (Case No. 09-14817); Apache Framing, LLC (Case No. 09-14818); Geronimo Plumbing LLC (Case No. 09-14820); Gung-Ho Concrete LLC (Case No. 09-14822); Bravo, Inc. (Case No. 09-14825); Elkhorn Partners, A Nevada Limited Partnership (Case No. 09-14828); Six Feathers Holdings, LLC (Case No. 09-14833); Elkhorn Investments, Inc. (Case No. 09-14837); Jarupa, LLC (Case No. 09-14839); Rhodes Realty, Inc. (Case No. 09-14841); C & J Holdings, Inc. (Case No. 09-14843); Rhodes Ranch General Partnership (Case No. 09-14844); Rhodes Design and Development Corporation (Case No. 09-14846); Parcel 20, LLC (Case No. 09-14848); Tuscany Acquisitions IV, LLC (Case No. 09-14849); Tuscany Acquisitions III, LLC (Case No. 09-14850); Tuscany Acquisitions II, LLC (Case No. 09-14852); Tuscany Acquisitions, LLC (Case No. 09-14853); Rhodes Ranch Golf Country Club, LLC (Case No. 09-14854); Overflow, LP (Case No. 09-14856); Wallboard, LP (Case No. 09-14858); Jackknife, LP (Case No. 09-14860); Batcave, LP (Case No. 09-14861); Chalkline, LP (Case No. 09-14862); Glynda, LP (Case No. 09-14865); Tick, LP (Case No. 09-14866); Rhodes Arizona Properties, LLC (Case No. 09-14868); Rhodes Homes Arizona, L.L.C. (Case No. 09-14882); Tuscany Golf Country Club, LLC (Case No. 09-14884); and Pinnacle Grading, LLC (Case No. 09-14887).

TABLE OF CONTENTS

	<u>Page</u>
PRELIMINARY STATEMENT	6
PROCEDURAL BACKGROUND.....	9
A. General Background Information	10
B. Bravo Hires Union Pacific as a Subcontractor.	11
C. Kahre is Convicted of Tax Fraud.....	13
D. The IRS's Untimely Assessment	14
E. The IRS Files its Claim Against Bravo for Union Pacific's Unpaid Taxes.....	14
ARGUMENT	15
I THE IRS CLAIM IS BARRED BY THE STATUTE OF LIMITATIONS.....	15
II THE IRS BEARS THE BURDEN OF PROVING BY CLEAR AND CONVINCING EVIDENCE THAT BRAVO COMMITTED FRAUD WITH INTENT TO EVADE TAX, AND NO SUCH EVIDENCE EXISTS.....	16
III THE IRS CANNOT ESTABLISH THAT BRAVO IS THE EMPLOYER RESPONSIBLE FOR THE TAXES SET FORTH IN THE IRS CLAIM.	18
A. Bravo Was Not the Employer Because Bravo Did Not Control Payment of the Workers' Wages	21
B. The Balance of the Common Law Factors Weighs in Favor of Finding that Union Pacific is the Employer of the Workers at Issue.....	23
IV BRAVO IS NOT LIABLE FOR ANY PENALTIES.....	29
V THE IRS GROSSLY MISCALCULATED THE INTEREST DUE.....	30
CONCLUSION.....	30

TABLE OF AUTHORITIES

	Page(s)
CASES	
<i>Badaracco v. C.I.R.</i> , 464 U.S. 386 (1984).....	16
<i>Blue Lake Rancheria v. United States</i> , 651 F.3d 1112 (9th Cir. 2011)	24
<i>Brown v. Comm’r</i> , 418 F.2d 574 (9th Cir. 1969)	16
<i>Brown v. Comm’r</i> , T.C.M. 1968-29, Docket Nos. 3387-65, 1971-66, 2209-66, 1968 WL 1152 (U.S.T.C. Feb. 19, 1968)	16
<i>Clackamas Gastroenterology Assocs., P.C. v. Wells</i> , 538 U.S. 440 (2003).....	25
<i>Hansen v. Comm’r</i> , T.C.M. 1981-98, Docket No. 11617-77, 1981 WL 10875 (U.S.T.C. Feb. 26, 1981).....	16, 17
<i>Helvering v. Taylor</i> , 293 U.S. 507 (1935).....	19
<i>George v. Comm’r</i> , 338 F.2d 221 (1st Cir. 1964).....	17
<i>Goldberg v. Comm’r</i> , 239 F.2d 316 (5th Cir. 1956)	17
<i>In re Galletti</i> , No. LA 99-48587-ER, 2000 WL 1682960 (Bankr. C.D. Cal. Sep. 11, 2000).....	15, 16
<i>In re Galletti</i> , No. ED CV 00-00753 VAP, 2001 WL 752652 (C.D. Cal. Mar. 23, 2001).....	15
<i>In re Galletti</i> , 314 F.3d 336 (9th Cir. 2002)	15
<i>In re Olshan</i> , 356 F.3d 1078 (9th Cir. 2004)	16, 19
<i>In re Sw. Rest. Sys. (“Southwest”)</i> , 607 F.2d 1237 (9th Cir. 1979)	22, 23
<i>Kittlaus v. United States</i> , 41 F.3d 327 (7th Cir. 1994)	23

1	<i>Nationawide Mut. Ins. Co. v. Darden</i>	
	503 U.S. 318 (1992).....	25
2	<i>Olinger v. Comm’r,</i>	
3	234 F.2d 823 (5th Cir. 1956)	17
4	<i>Otte v. United States,</i>	
5	419 U.S. 43 (1974).....	22
6	<i>Palmer v. U.S. Internal Revenue Service,</i>	
	116 F.3d 1309 (9th Cir. 1997)	19
7	<i>Raleigh v. Ill. Dept. of Revenue,</i>	
8	530 U.S. 15 (2000).....	16
9	<i>Transp. Labor Contract/Leasing, Inc. v. Comm’r,</i>	
10	123 T.C. 154 (2004).....	<i>passim</i>
11	<i>Transp. Labor Contract/Leasing, Inc. v. Comm’r,</i>	
	T.C.M. 2005-173, Nos. 1188-01, 2005 WL 1649136 (U.S.T.C. July 14, 2005)	24
12	<i>Transp. Labor Contract/Leasing, Inc. v. Comm’r,</i>	
13	461 F.3d 1030 (8th Cir. 2006)	24
14	<i>Valetti v. Comm’r,</i>	
15	260 F.2d 185 (3d Cir. 1958).....	17
16	<i>U.S. v. Galletti,</i>	
	541 U.S. 114 (2004).....	15
17	<i>Weimerskirch v. Comm’r,</i>	
18	596 F.2d 358 (9th Cir. 1979)	19
19	STATUTES	
20	11 U.S.C. § 502(b)	15
21	11 U.S.C. § 502(b)(1)	15
22	26 U.S.C. § 6501(a)	15
23	26 U.S.C. § 6501(c)(1)	16
24	26 U.S.C. § 6651.....	29
25	26 U.S.C. § 6656.....	29
26	26 U.S.C. § 6663(a)	29
27	26 U.S.C. § 7454.....	16, 30
28		

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26 U.S.C. § 7454(a)	16
26 U.S.C. § 3401(d)(1)	22, 24
Tax Ct. R. 142(b)	16
Treasury Regulations § 31.3121(d) – 1(c)(2)	20

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2 **TO THE HONORABLE LINDA B. RIEGLE, UNITED STATES BANKRUPTCY JUDGE:**

3 The above-captioned reorganized debtors (collectively, the “Reorganized Debtors”)
4 hereby submit this pre-trial brief in support of their objection previously filed to claim No. 7 (as
5 amended from time to time, the “IRS Claim”) filed by the Internal Revenue Service (the “IRS”)
6 against Debtor Bravo, Inc.² (“Bravo”, and, together with the IRS, the “Parties”) and respectfully
7 represent as follows:

8 **PRELIMINARY STATEMENT**

9 In this action, the IRS seeks hundreds of thousands of dollars in back taxes—and millions
10 more in penalties and interest—solely on the basis of Bravo’s unfortunate hiring, many years
11 ago, of a subcontractor, Union Pacific Construction (“Union Pacific”), who failed to properly
12 withhold and pay employment taxes for its employees.

13 The IRS’s cupped hand reaches unusually far here, grounded only on its novel and
14 unsupported theory that Union Pacific, a construction company, was not Bravo’s subcontractor
15 but rather a mere provider of payroll services to Bravo, and that the employees of *Union Pacific*
16 were actually employees of *Bravo*. Fatally to its claim, however, the IRS has no direct evidence
17 to support this theory. Instead, it has offered only the irrelevant testimony of low-level
18 employees whose testimony is not based on their personal knowledge, but instead consists of
19 hearsay, circumstantial evidence, and legal conclusions absent any foundation or expertise.

20 The IRS Claim is not only meritless; it is also time-barred. Any internal revenue tax,
21 including employment tax, must be assessed within three years of the date the tax return was
22 filed.³ In an examination report dated March 23, 2010, many years after the respective
23 limitations periods had expired, the IRS proposed adjustments to Bravo’s returns for 2000, 2001,
24 2002, and 2003. Those adjustments have not been assessed but were incorporated into the IRS
25 proof of claim. The IRS proof of claim was initially filed on September 25, 2009, which also

26
27 ² The IRS’s proof of claim was in fact filed against Bravo LLC, a non-existent entity. The Reorganized Debtors
reserve all rights with respect to this error should the IRS fail to correct it by amendment.

28 ³ For this purpose certain employment and withholding tax returns (including those here at issue) are deemed filed
April 15 of the succeeding year (if filed by then). 26 U.S.C. § 6501(b)(2).

1 was many years after the respective limitations periods had expired. It is well-settled that a
2 claim that is unenforceable as time-barred under applicable law shall be disallowed in
3 bankruptcy.

4 Having failed to conduct a timely assessment, the IRS will presumably attempt to
5 shoehorn its claim into the fraud exception to the three-year limitations period. To do so,
6 however, the government must prove *both* (1) the underlying tax liability *as against Bravo*,
7 including the essential element that the workers at issue were employees of Bravo, not Union
8 Pacific; and (2) that Bravo committed fraud with intent to evade payment of the underlying tax.
9 Failure to prove *either* fraud or underlying liability ends the government's case. Moreover, the
10 government must prove both the fraud and the underlying liability *by clear and convincing*
11 *evidence*. The government can prove neither. First, there is simply no evidence of fraud on the
12 part of Bravo—Union Pacific's fraud is not Bravo's fraud. The IRS has not even *alleged* that
13 Bravo committed fraud in any of its pleadings to date.⁴ Second, with respect to the underlying
14 liability, the IRS cannot even meet the lesser burden of preponderance of the evidence. Viewed
15 against the higher standard of clear and convincing evidence applicable here, the IRS's meager
16 evidentiary offering falls far short.

17 The Reorganized Debtors plan to rebut the government's evidence with testimony from
18 the CFO of Rhodes Homes and the Construction Manager of Bravo, senior management-level
19 employees with direct personal knowledge of Bravo's relationship with Union Pacific and
20 Bravo's employment practices. They will testify that (i) Bravo hired Union Pacific as a
21 subcontractor; (ii) at the time the agreement was entered into, Union Pacific was a well-known
22 construction company in the region and was viewed within the industry as a reputable operation;
23 (iii) Bravo's clear understanding was that Union Pacific would have the sole responsibility for its
24 employees, including withholding and paying taxes, providing worker's compensation insurance,
25 hiring and firing, allocating and assigning workers to projects, provided training and tools as
26 needed, and ensuring the work was properly performed; (iv) during the time periods in question,

27
28 ⁴ At the September 27, 2011 hearing, while discussing penalties, the Reorganized Debtors pointed out that no
allegations had been made that Bravo possessed the requisite scienter to constitute fraud. *See* 9/27/11 Tr. at 18:14-
18:18. The IRS, though present, had no response to this point.

1 Bravo correctly paid taxes for its own employees; (v) Bravo maintained and processed its own
2 payroll for hundreds of its own employees, filed the required returns and deposited the
3 corresponding employment and withholding taxes; and (vi) Bravo had no knowledge that Union
4 Pacific was engaged in a fraudulent tax scheme not to pay taxes for its own employees.

5 Ultimately, the evidence will convincingly show that the workers at issue were in fact
6 employees of Union Pacific, not Bravo. As an initial matter, Bravo had no control over payment
7 of the workers' wages. Thus, under the plain language of the Internal Revenue Code, and
8 controlling legal precedent, Bravo is not the workers' employer for purposes of employment tax
9 withholding. Second, should the Court proceed to weigh the common law employment factors,
10 it will find that they, too, weigh heavily in favor of a finding that Union Pacific, not Bravo, is the
11 employer.

12 The penalties portion of the IRS Claim fails for the simple reason that where there is no
13 underlying liability, there is no penalty. Moreover, to prevail on its claim for fraud penalties, the
14 IRS bears the burden of proving by clear and convincing evidence that Bravo acted with
15 fraudulent intent to evade taxes. The IRS has not alleged, much less proven, anything
16 approaching fraudulent intent. Although Union Pacific engaged in fraudulent activity, there is
17 no evidence that Bravo—or anyone else at the time—was aware of or knowingly participated in
18 Union Pacific's fraudulent scheme.

19 Finally, compounding the IRS Claim's lack of timeliness and merit, the IRS grossly
20 miscalculates the interest on the underlying taxes, claiming interest on the general unsecured
21 claims of \$849,130.51, more than quadruple the correct amount of \$196,509.04. This overreach
22 alone teeters on the edge of frivolousness, and demonstrates that the IRS Claim as a whole is
23 both arbitrary and excessive.

24 For the reasons set forth herein, the IRS Claim should be disallowed and expunged.
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PROCEDURAL BACKGROUND

On March 31, 2009 (the “Petition Date”), Bravo, one of the above-captioned Debtors,⁵ filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. On September 25, 2009, the IRS filed its proof of claim No. 7-1 as a priority claim in the amount of \$1,285,683.50 against Bravo in the bankruptcy case numbered 09-14825. On April 13, 2010, the IRS filed an amended proof of claim No. 7-2 against Bravo. The amended proof of claim included a priority claim in the amount of \$1,326,068.11 and an unsecured claim in the amount of \$2,560,388.64, for a total claim of \$3,886,456.75 against Bravo.⁶

On March 31, 2011, the Reorganized Debtors filed the *Reorganized Debtors’ Objection to Claim No. 7 Filed by the Internal Revenue Service Against Debtor Bravo, Inc. Pursuant to Sections 105, 502(b) and 505 of the Bankruptcy Code and Bankruptcy Rules 3001, 3003, and 3007* [Docket No. 1377] (the “Objection”). By the Objection, the Reorganized Debtors requested that this Court enter an order disallowing the IRS Claim in its entirety. The Court scheduled a hearing regarding the IRS Claim on June 24, 2011.

On June 22, 2011, this Court entered an order approving the scheduling stipulation entered into between the Parties continuing the June 24, 2011 hearing. The Court subsequently re-scheduled the hearing for September 27, 2011 (the “Hearing”). Based upon the Parties’ agreement, the IRS’s response deadline to the Objection was extended to September 16, 2011. The Reorganized Debtors’ reply deadline was extended to September 21, 2011.

On September 15, 2011, the IRS filed its *Opposition to the Debtors’ Objection to IRS Claim Filed Against Bravo, Inc.* [Docket No. 1540] (the “Opposition”). On September 21, 2011,

⁵ Capitalized terms used but not otherwise defined herein shall have the meaning ascribed to them in the *Reorganized Debtors’ Objection to Claim No. 7 Filed by the Internal Revenue Service Against Debtor Bravo, Inc. Pursuant to Sections 105, 502(b) and 505 of the Bankruptcy Code and Bankruptcy Rules 3001, 3003, and 3007* [Docket No. 1377].

⁶ A true and correct copy of the IRS Claim is attached to the accompanying Declaration of Justin Bell, dated February 13, 2012 (“Bell Declaration” or “Bell Decl.”), as **Exhibit A**.

1 the Reorganized Debtors filed their *Reply in Support of Objection to Claim No. 7 Filed by the*
 2 *Internal Revenue Service Against Debtor Bravo, Inc., etc.* [Docket No. 1553] (the “Reply”).

3 At the Hearing, the Court heard oral argument with respect to the IRS Claim and, for the
 4 reasons set forth on the record, set the matter down for trial on March 5, 2012.

5 On January 26, 2012, the Parties filed their *Joint Pre-Trial Statement* [Docket No. 1640]
 6 (the “Pre-Trial Statement”).

7 Although the parties have continued to engage in good faith settlement discussions, as of
 8 the time of filing this pre-trial brief, the parties have not yet reached an agreement to resolve the
 9 Objection.
 10

11 **FACTUAL BACKGROUND**

12 **A. General Background Information**

13 Bravo was a Nevada-based corporation that specialized in framing houses for certain
 14 Debtors’ homebuilding operations. In the ordinary course of its business, Bravo (or certain
 15 affiliates on Bravo’s behalf) maintained books and records, that, among other things, reflected
 16 Bravo’s tax liability to the IRS and other governmental units in the State of Nevada. Included in
 17 Bravo’s books and records was information regarding its withholdings as well as its FICA tax
 18 obligations. At all relevant times, Bravo filed tax returns with the necessary taxation authorities,
 19 including the IRS and the State of Nevada, either directly or through its affiliates. Bravo ceased
 20 operations in or around 2007, approximately two years prior to the Petition Date.
 21

22 On April 13, 2010, the IRS filed the IRS Claim seeking \$3,886,456.75 as a result of
 23 Bravo’s alleged failure to pay various employment-related taxes from approximately 2000
 24 through 2003 (the “Relevant Period”). In addition to its payment claims, the IRS also seeks
 25 various penalties against Bravo. The IRS Claim is premised upon certain amounts due to the
 26 IRS as a result of actions by Union Pacific, a company *wholly unaffiliated* with Bravo or any
 27 other Debtors. The IRS’s claims are as follows:
 28

<u>Element of the Claim</u>	<u>Amount</u>
IRS's priority claim for Bravo's FICA and withholding taxes for the Relevant Period	\$879,452.54
IRS's priority claim for interest associated with the above tax obligations	\$446,615.57
Total Priority Claim	\$1,326,068.11
Unsecured penalties pursuant to §6651 (Failure to Pay), §6656 (Failure to Deposit), and §6663(a) (Fraud)	\$431,179.11
Interest accumulated on the above unsecured penalties	\$849,130.51
Penalty on unsecured general claims	\$1,280,309.62
Total Unsecured Claim⁷	\$2,560,388.64
Total Amount of Claim:	\$3,886,456.75

The IRS Claim is based on an examination report dated March 23, 2010 (the "Examination Report"), in which the IRS proposed adjustments to Bravo's liability for taxes on its returns for 2000-2003, including fraud penalties.⁸

B. Bravo Hires Union Pacific as a Subcontractor.

In the early 2000's, during the housing market boom, Bravo was extremely busy on a number of building projects and determined that it needed to hire additional crews in order to avoid falling behind. In addition, Bravo faced significant administrative burdens in determining and documenting the immigration status of many of its workers and new job applicants. *See* Transcript of the Deposition of Dean Griffith, dated Feb. 9, 2012 ("Griffith Transcript" or "Griffith Tr."), at 32:13-32:19.⁹ As a result of these and other reasons, Bravo decided to seek

⁷ Also included among the general unsecured claims are \$10,000 per year—an amount apparently pulled out of thin air—of federal unemployment taxes. *See* IRS Claim, at 2-3.

⁸ A true and correct copy of the Examination Report is attached to the Bell Declaration as **Exhibit B**. An examination report is typically a preliminary report of audit findings rather than a final determination of a deficiency. Assessments, by contrast, are final determinations of deficiency usually sent to the taxpayer in letter form. Assessments of deficiencies may differ from an examination report.

⁹ A true and correct copy of excerpts of the Griffith Transcript is attached to the Bell Declaration as **Exhibit C**.

1 additional workers from Union Pacific. *See* Declaration of Dean Griffith, dated September 7,
 2 2011 (“Griffith Declaration” or “Griffith Decl.”) at ¶ 4 [Docket No. 1532].¹⁰

3 Following this determination, Bravo’s superintendent, Dean Griffith (“Griffith”), met
 4 with Robert Kahre (“Kahre”), the owner of Union Pacific, on one occasion to discuss Bravo’s
 5 evolving needs. Kahre represented to Griffith that Union Pacific could be hired as a
 6 subcontractor and could provide supplemental working crews for Bravo’s projects on a
 7 temporary, as-needed basis, thereby providing Bravo with the extra workers it needed without
 8 burdening Bravo with additional recordkeeping, insurance, and tax obligations because the
 9 workers would be employed by Union Pacific rather than Bravo. *See* Griffith Declaration at ¶ 4.
 10 On that basis, Bravo agreed to engage Union Pacific as a subcontractor beginning in the early
 11 2000’s. *Id.* Pursuant to their agreement, Union Pacific would provide laborers to work on
 12 Bravo’s building projects.
 13

14 To that end, Union Pacific supplied Bravo with the manual labor necessary to meet the
 15 demands of an ever-increasing project load. Union Pacific provided its own employees and
 16 hired certain Bravo employees—with Bravo’s consent—as its own employees. Union Pacific
 17 had the sole responsibility to pay its own employees—including those employees hired from
 18 Bravo—who worked on Bravo’s projects. Union Pacific further represented that it would be
 19 responsible for all other matters within the purview of human resources including, but not
 20 limited to, payroll, worker’s compensation insurance, resolution of labor disputes, and
 21 withholding and payment of taxes to the proper taxing authorities. *Id.* at ¶ 5. If work was not
 22 performed to Bravo’s satisfaction, Union Pacific was responsible to correct any problems.
 23
 24

25 After Bravo hired Union Pacific as a subcontractor, Bravo continued to maintain its own
 26 employees, hourly as well as salaried, for whom it continued to pay taxes. *Id.* at ¶ 6. Bravo
 27
 28

¹⁰ A true and correct copy of the Griffith Declaration is attached to the Bell Declaration as **Exhibit D**.

1 employees were paid by Bravo, and Union Pacific employees were paid by Union Pacific.¹¹

2 Thus, each entity was responsible for withholding taxes from its employees and remitting such
3 payments to the IRS.

4 **C. Kahre is Convicted of Tax Fraud**

5 On August 14, 2009, Kahre was convicted of underreporting certain information
6 regarding wages, withholding, and employment taxes to the IRS with respect to his construction
7 business and other businesses. Unbeknownst to Bravo, Kahre had devised a scheme that
8 concealed the true amount of compensation paid to employees of the companies he controlled,
9 including Union Pacific. Kahre claimed to pay employees in gold and silver coins but allowed
10 the employees to exchange the coins immediately for pre-determined amounts of cash that were
11 worth more than the face value of the coins. Kahre would then advise the employees that their
12 income was not taxable or that they should falsely report their income to the IRS as the face
13 value of the gold and silver coins. As a result, no federal tax withholdings were made from the
14 paychecks of persons employed by Kahre and his companies and companies for which he
15 provided payroll services, and their wages were never reported to the IRS. On November 17,
16 2009, Kahre was sentenced to 15 years and 10 months in prison for his participation in the tax
17 evasion scheme.
18

19
20 The CFO of Rhodes during the Relevant Period, Jim Bevan, will testify that Kahre once
21 proposed to Mona Wilcox, a former controller at Bravo, that Bravo pay Union Pacific amounts
22 owed under the subcontracting agreement in gold or silver coins. Ms. Wilcox passed the request
23 on to Mr. Bevan, who immediately and unequivocally rejected the proposal on behalf of Bravo.
24 Afterwards, Mr. Bevan assumed the issue had been put to rest. Bravo was not aware that Kahre
25 or Union Pacific had failed to pay/withhold taxes or that it had paid its own employees in gold
26

27
28 ¹¹ The evidence will show that, to the extent that any individual employee worked part time for Bravo and part the time for Union Pacific, such employee was paid by Bravo for services performed for Bravo, and Bravo withheld and deposited taxes, and reported such employee's wages on Form W-2.

1 and silver. When Bravo learned of Union Pacific's silver and gold coin payment scheme in
 2 2003, Bravo immediately terminated its relationship with Union Pacific and Kahre. *Id.* at ¶ 7.
 3 With respect to its own employees, Bravo always maintained the required payroll records and
 4 satisfied all of its tax withholding, payment, and reporting obligations.

5 **D. The IRS's Untimely Assessment.**

6 Throughout the Relevant Period, Bravo filed each of its required Forms 940 (annual
 7 unemployment tax returns) and Forms 941 (quarterly employment tax returns). As the
 8 Reorganized Debtors will show at trial, the Forms 940 were filed on September 24, 2001,
 9 February 25, 2002, April 1, 2002, March 1, 2003, and March 24, 2004, and the Forms 941 were
 10 filed on June 26, 2000, September 11, 2000, December 25, 2000, September 17, 2001,
 11 September 24, 2001, February 25, 2002, March 25, 2002, April 1, 2002, June 24, 2002,
 12 September 23, 2002, November 25, 2002, March 3, 2003, June 23, 2003, September 8, 2003, and
 13 March 24, 2004.¹² However, the allegedly underpaid taxes now claimed by the IRS in
 14 connection with these forms have not been assessed, but were included in an examination report
 15 dated March 23, 2010.¹³

16
 17
 18 **E. The IRS Files its Claim Against Bravo for Union Pacific's Unpaid Taxes**

19 As stated above, the IRS filed its initial claim on September 25, 2009, and an amended
 20 claim on April 13, 2010. The IRS seeks payment from Bravo for *Union Pacific's* and *Kahre's*
 21 failure to pay taxes. The IRS asserts that Bravo did not hire Union Pacific as a subcontractor but
 22 rather as a payroll services provider and that, therefore, the Union Pacific workers were actually
 23 Bravo employees. Accordingly, the IRS claims that, to the extent that Union Pacific failed to
 24 pay employment taxes, Bravo remains obligated to make those payments as the actual employer
 25

26
 27 ¹² Though several of these returns were late when filed, Bravo *paid* the appropriate penalties for late filings at the
 time. None of the filings were so late as to have any effect on the Reorganized Debtors' statute of limitations
 argument.

28 ¹³ See also IRS Claim, at 2-3 (listing "EXAM" under the column entitled "Date Tax Assessed", with no date of
 assessment).

of the workers. The Reorganized Debtors disagree. The Reorganized Debtors will prove that the IRS is improperly looking to Bravo to indemnify it for Kahre's fraudulent conduct. Bravo paid Union Pacific as a subcontractor to provide additional laborers for its framing business. Bravo did not employ any of the workers that Union Pacific provided to Bravo pursuant to the subcontracting agreement. All workers provided by Union Pacific were Union Pacific employees and, thus, the IRS must look to Union Pacific to satisfy its claim. As such, Union Pacific's failure to remit to the government certain withholding taxes for the laborers should not obligate Bravo or the Reorganized Debtors to make payments on their behalf.

ARGUMENT

I. THE IRS CLAIM IS BARRED BY THE STATUTE OF LIMITATIONS.

Pursuant to 11 U.S.C. § 502(b), where a claim filed under the bankruptcy code is objected to, the court shall disallow such claim "to the extent that ... (1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law." 11 U.S.C. § 502(b)(1). Accordingly, where a claim is barred by the applicable statute of limitations, it must be disallowed in bankruptcy. *See In re Galletti*, No. LA 99-48587-ER, 2000 WL 1682960, at *5 (Bankr. C.D. Cal. Sept. 11, 2000) (disallowing portion of tax claim not assessed within three years after return was filed), *affirmed by In re Galletti*, No. ED CV 00-00753 VAP, 2001 WL 752652 (C.D. Cal. Mar. 23, 2001), *affirmed by In re Galletti*, 314 F.3d 336 (9th Cir. 2002), *reversed on other grounds by U.S. v. Galletti*, 541 U.S. 114 (2004).

Here, the applicable statute of limitations is set forth in 26 U.S.C. § 6501(a), which provides that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed" and further that "no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period." 26 U.S.C. § 6501(a). Because Bravo filed Forms 940 and 941 for the applicable periods in 2000-2004, the respective statutes of limitations expired in April 2004, 2005, 2006, and 2007. Indeed, the returns for the last disputed year and the last disputed quarter were both filed on March 24, 2004, which means that as of March 25, 2007, the limitations periods had run with respect to *each and every* tax

1 period during the four years at issue here. The entire IRS Claim is thus barred by the statute of
 2 limitation. *Id.*; *see also In re Galletti*, 2000 WL 1682960, at *5. Even had the proposed
 3 adjustments contained in the March 23, 2010 examination report been assessed at that time, they
 4 would have been time barred. Lacking a timely assessment of the allegedly owed taxes at issue,
 5 and absent the IRS establishing fraud by Bravo, the IRS cannot now pursue its claim in court,
 6 nearly five years after the expiration of the last limitations period at issue. *Id.*

7
 8 **II. THE IRS BEARS THE BURDEN OF PROVING BY CLEAR AND CONVINCING**
 9 **EVIDENCE THAT BRAVO COMMITTED FRAUD WITH INTENT TO EVADE TAX,**
 10 **AND NO SUCH EVIDENCE EXISTS.**

11 Unless it withdraws the IRS Claim, the IRS must establish that the fraud exception to the
 12 statute of limitations applies.¹⁴ There is indeed no time limitation on when the IRS may assess a
 13 fraudulent return filed with the intent to evade taxes. 26 U.S.C. § 6501(c)(1). However, the
 14 burden of proving that an exception to the statute of limitations applies lies squarely on the IRS.
 15 *Badaracco v. C.I.R.*, 464 U.S. 386 (1984).¹⁵ The burden of proof is on the IRS in any case
 16 involving the issue of whether the petitioner has been guilty of fraud with intent to evade tax. 26
 17 U.S.C. §7454.

18 To carry this burden, the IRS must prove “by clear and convincing evidence” that Bravo
 19 engaged in “intentional wrongdoing with the specific purpose of evading a tax believed to be
 20 owing.” *Hansen v. Comm’r of Internal Revenue*, T.C. M. 1981-98, Docket No. 11617-77, 1981
 21 WL 10875 (U.S.T.C. Feb. 26, 1981); *Brown v. Commissioner*, T.C. M. 1968-29, Docket Nos.
 22 3387-65, 1971-66, 2209-66, 1968 WL 1152 (U.S.T.C. Feb. 19, 1968) (same), *aff’d per curiam*
 23 418 F.2d 574 (9th Cir. 1969); *see also* 26 U.S.C. 7454(a); Tax Ct. R. 142(b) (“In any case
 24 involving the issue of fraud with intent to evade tax, the burden of proof in respect of that issue is
 25 on the respondent, and that burden of proof is to be carried by clear and convincing evidence.”).

26 ¹⁴ The fraud exception provides that “[i]n the case of a false or fraudulent return with the intent to evade tax, the tax
 27 may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.”
 28 26 U.S.C. § 6501(c)(1).

¹⁵ A bankruptcy court adjudicating a tax claim by the IRS must apply the burden-of-proof rubric normally applied
 under tax law. *In re Olshan*, 356 F.3d 1078, 1084 (9th Cir. 2004) (citing *Raleigh v. Ill. Dep’t of Revenue*, 530 U.S.
 15, 20-21 (2000)).

1 In *Hansen*, the court referenced *George v. Comm’r*, 338 F.2d 221 (1st Cir. 1964), a case in which
2 the First Circuit—considering whether the fraud exception to the statute of limitations applied—
3 held that the IRS could not rely on the presumption of correctness of its determination that taxes
4 were deficient or underpaid. Rather, the court held that the IRS must establish deficiency or
5 underpayment by evidence, and that the IRS must not be allowed “to raise [itself] by [its] own
6 bootstraps.” *Id.* (citing *Goldberg v. Comm’r*, 239 F.2d 316 (5th Cir. 1956); *Olinger v. Comm’r*,
7 234 F.2d 823 (5th Cir. 1956); *cf. Valetti v. Comm’r*, 260 F.2d 185, 188 (3d Cir. 1958)).

8 Clear and convincing evidence has been described as “impressively more” than a
9 preponderance of the evidence. *Valetti v. Comm’r*, 260 F.2d at 188 (holding that compounding
10 of evidentiary inferences by IRS was insufficient to prove fraud by clear and convincing
11 evidence). Thus, it is “often” the case that even where the IRS might prevail under a
12 preponderance of the evidence standard, it will nonetheless fail on the same evidence to establish
13 fraud. *Id.*

14 Moreover, the IRS bears this heightened burden with respect to “every subsidiary fact
15 relied upon by the court to support that ultimate conclusion,” including the underpayment of the
16 tax at issue. *Hansen*, 1981 WL 10875. Here, accordingly, the IRS must prove by clear and
17 convincing evidence both (1) every element of the underlying tax liability as against Bravo,
18 including that the workers at issue were employees of Bravo, not Union Pacific; and (2) that
19 Bravo committed fraud with intent to evade payment of the underlying tax. Failure by the IRS to
20 prove either fraud or underlying liability is fatal to its case.

21 The IRS has not come forward with any evidence that Bravo possessed a fraudulent
22 intent to evade taxes because no such evidence exists. Indeed, the IRS has not even made *any*
23 allegations of fraud against Bravo in any of its pleadings to date. To establish intent in the case
24 at bar, the IRS would have to establish that Bravo *knew* that it owed taxes on the workers that it
25 believed to be Union Pacific employees and actively concealed its activities from the IRS. There
26 is simply no evidence that Bravo had any such knowledge. On the contrary, the CFO of Rhodes
27 and the general manager of Bravo will both testify that at all times they considered the workers
28 managed by Union Pacific to be employees of Union Pacific as opposed to Bravo. Indeed, it was

1 Bravo's understanding that Union Pacific would be handling all incidents of the workers
2 employment, including payment of wages, withholding and payment of taxes, and sponsorship of
3 benefits and worker's compensation. Moreover, the fact that Union Pacific represented to Bravo
4 that Union Pacific would be withholding and paying taxes to the IRS on the workers at issue
5 directly contradicts the notion that Bravo was complicit in concealment of any kind.

6 Further, the lack of any incentive by Bravo to commit fraud also strongly suggests that
7 Bravo's actions with respect to hiring Union Pacific were not fraudulent. As Mr. Griffith will
8 testify, Bravo paid Union Pacific an 18.5% administrative "burden", which was a percentage
9 added on to its invoices to cover the cost of payroll taxes, worker's compensation, FICA and
10 administrative personnel. Griffith Tr., at 60:7-62:7, 68:13-69:20. When Bravo performed these
11 functions internally, as it did with its own payroll, its administrative burden was similar,
12 fluctuating between 15% and 20%. *Id.* at 69:9-69:13. It defies logic and common sense to
13 suggest that Bravo's specific intent in contracting with Union Pacific was to evade taxes where
14 there was absolutely no cost savings or other financial incentive for Bravo to do so.

15 Finally, even circumstantial evidence points toward a lack of fraudulent intent. Bravo
16 maintained records, in the form of invoices received from Union Pacific, of every dollar paid to
17 any Union Pacific worker on one of Bravo's jobs, evidencing that Bravo concealed nothing and
18 believed it had nothing to hide. And when Robert Kahre proposed to Bravo that *he* be paid in
19 gold and silver for his services as subcontractor, his proposal was flatly rejected, evidence that
20 Bravo would not accept any arrangement that it knew to be anything less than fully above board.

21 Because the IRS cannot carry its burden of proving fraud on the part of Bravo by clear
22 and convincing evidence, its claim is time-barred and must be disallowed. Moreover, the IRS
23 Claim must be disallowed for the additional reason, set forth below, that the IRS cannot prove
24 any underpayment of taxes.

25
26 **III. THE IRS CANNOT ESTABLISH THAT BRAVO IS THE EMPLOYER**
27 **RESPONSIBLE FOR THE TAXES SET FORTH IN THE IRS CLAIM.**

28 Even assuming *arguendo* that the statute of limitations did not bar the IRS's claim, the
IRS still bears the initial burden of proof on the issue of whether Bravo is the employer of the

workers at issue. “In an action to collect taxes, the government bears the initial burden of proof.” *In re Olshan*, 356 F.3d at 1084. (quoting *Palmer v. U.S. Internal Revenue Service*, 116 F.3d 1309, 1312 (9th Cir. 1997)). In order to satisfy its initial burden, the IRS “must offer some foundational support” for its claim and “provide some predicate evidence connecting the taxpayer to the charged activity.” *Weimerskirch v. Comm’r*, 596 F.2d 358, 361 (9th Cir. 1979). If, and only if, the IRS satisfies this initial burden (and assuming the statute of limitations does not apply), a presumption of correctness will apply to its tax determination. *Id.* If the IRS satisfies its initial burden, the debtor may rebut the presumption by a showing “that [the IRS’s] determination is arbitrary, excessive or without foundation.” *In re Olshan*, 356 F.3d at 1084 (citing *Helvering v. Taylor*, 293 U.S. 507, 515-16 (1935)). Once the presumption of correctness is rebutted, the burden of proof shifts back to the IRS, *id.*, which must then prove every element of its claim by a preponderance of the evidence. Here, the Reorganized Debtors have submitted evidence that more than rebuts the IRS’s initial presumption with evidence that the IRS’s determination that workers at issue were Bravo employees is completely without foundation.¹⁶ Thus, even if the statute of limitations were inapplicable, the IRS would still be required to prove its case by a preponderance of the evidence, which it cannot do, and it would still need to prove its case by clear and convincing evidence to the extent it seeks to impose the penalty for fraud under 26 U.S.C. §6663.

Because the statute of limitations has run, however, the government must prove every element of its claim by the heightened standard of clear and convincing evidence, including the element that Bravo is the employer of the workers at issue. At this task the IRS will certainly fail.

¹⁶ Courts are particularly loath to overlook a meager factual showing by the IRS where, as here, the alternative to placing the initial burden on the IRS would be to require the taxpayer to prove a negative proposition. *See Weimerskirch*, 596 F.2d at 361. In *Weimerskirch*, the government assessed deficiencies based on allegedly unreported income from the sale of heroin. The government offered no evidence, however, showing that the taxpayer had sold heroin or that he had received any unreported income. *Id.* at 361-62. Noting that “as a practical matter it is never easy to prove a negative,” the Court observed that “[e]ven the most innocent of persons would have difficulty in disproving such a serious charge as selling heroin, when the party making the charge was not required to present [a]ny evidence.” *Id.* at 361 (internal quotations omitted). Here, similarly, were the IRS not required to produce evidence that Bravo is indeed the employer of the workers at issue, the Reorganized Debtors would face the task of proving the negative proposition that it was *not* the employer of the workers at issue. For this reason, the law places the burden on the IRS. *Id.* Moreover, in this case, the burden on the IRS is to establish each element of the fraudulent underpayment of tax by clear and convincing evidence.

1 The IRS has offered no evidence in support of its allegation that Bravo is the employer of
 2 the workers at issue—a necessary element of the IRS’s claim.¹⁷ Rather than offer any
 3 substantive evidence of this element, as it is required to do, the IRS merely assumes it to be true.
 4 See Opposition ¶ 5 (referring to the workers at issue as “[t]he Bravo employees”) and ¶ 8
 5 (describing Bravo as “the actual employer” of the workers).

6 In the Pre-Trial Statement, the IRS identified several low-level Bravo employees whose
 7 testimony it intends to offer at trial. Pre-Trial Statement at 2. Such employees, however, have
 8 no knowledge relevant to the question of whether the workers at issue were Bravo employees
 9 within the meaning of the Internal Revenue Code. Moreover, any testimony they might offer on
 10 the question would necessarily be based on inadmissible hearsay or legal opinion as to which
 11 they are not competent to testify. For example, the IRS may present the testimony of James
 12 Garner, a former Bravo foreman. Mr. Garner testified that, although he and his crews always
 13 received paychecks from Bravo, (Transcript of the Deposition of James Garner, dated Jan. 18,
 14 2012 (“J. Garner Tr.”), at 13:1-13:11), certain crews ceased being paid by Bravo at a certain
 15 point and would from that point on be paid by Union Pacific through what Mr. Garner referred to
 16 as a “payroll service” (*id.* at 27:11-27:14; 29:19-29:22)¹⁸. Mr. Garner further testified that
 17 certain of these individuals were working for Bravo at the time. *Id.* at 27:3-27:4. Mr. Garner,
 18 however, had no personal knowledge about how anyone at Bravo or Union Pacific was being
 19 paid, or who anyone was employed by, other than the men on his own crew, who were all on
 20 Bravo’s payroll and received Bravo paychecks with taxes withheld. In general, Mr. Garner also
 21 had no personal knowledge of Bravo’s withholding and reporting practices. Moreover, the
 22 Reorganized Debtors’ evidence will show that Union Pacific was known throughout the
 23 construction industry as a sizeable construction company and contractor.

24 Against this evidence, the Reorganized Debtors will offer the testimony of the Rhodes
 25

26 ¹⁷ The IRS does not appear to dispute that whether Bravo is the employer of the workers is an essential element of
 27 its claim. See Opposition ¶ 2 (describing as the basis of Bravo’s purported tax obligations the requirements of
 28 “[e]mployers” to withhold certain taxes from wages paid to their “employees” and arguing that liability for such
 taxes falls to “employers”) (emphasis added).

¹⁸ A true and correct copy of excerpts from the Deposition of James Garner is attached to the Bell Declaration as
 Exhibit E.

1 CFO and the Bravo general manager, individuals who were actually in positions to have personal
 2 knowledge of Bravo's personnel matters. The construction manager of Bravo during the
 3 Relevant Period, Dean Griffith, declared and will testify at trial based on direct, personal
 4 knowledge that Union Pacific was hired by Bravo as a subcontractor to provide labor. Griffith
 5 Decl. at ¶ 4. Mr. Griffith further declared and will testify that, in contrast to its treatment of its
 6 own employees, Bravo neither (1) hired nor fired the workers at issue; (2) did not pay such
 7 workers' wages; (3) did not provide the workers with workers compensation or health insurance
 8 benefits; (4) did not control the workers schedules; (5) did not dictate how and when their work
 9 was performed; (6) did not discipline the workers; (7) was not responsible for treatment of their
 10 on-the-job injuries; and (8) did not offer the workers at issue the opportunity to receive tools
 11 through the wage-deduction tool purchasing program that Bravo offered to its employees. *See*
 12 Griffith Decl. at ¶ 5.

13 The Reorganized Debtors also plan to introduce testimony from Jim Bevan, the CFO of
 14 Rhodes Homes during the Relevant Period, who will testify that every employee that worked for
 15 any Rhodes company, including Bravo, received his or her wages by paycheck. Mr. Bevan will
 16 also testify that Mona Wilcox approached him to relay a request from Robert Kahre that Bravo
 17 pay Union Pacific for its work as subcontractor in gold coin and that Mr. Bevan unequivocally
 18 refused the request.

19 The evidence that the IRS proposes to offer falls hopelessly short of satisfying the IRS's
 20 burden of proving by clear and convincing evidence that Bravo is the employer of the workers at
 21 issue. First, Bravo had no control—both as a legal and a factual matter—over payment of the
 22 workers' wages. Under controlling precedent, this should end the question of Bravo's liability.
 23 Second, should the Court proceed to weigh the common law employment factors, it will find that
 24 they too weigh heavily in favor of a finding that Union Pacific, not Bravo, is the employer.
 25 Indeed, though the burden of proof is not borne by Bravo, the evidence will nonetheless show
 26 that Bravo was not the employer responsible for the taxes appearing on the Proof of Claim.

27
 28 **A. Bravo Was Not the Employer Because Bravo Did Not Control Payment of
 the Workers' Wages.**

1 Bravo is not responsible for the FICA and withholding taxes asserted in the IRS Claim
 2 because, as will be established at trial, Bravo had no control over the payment of wages to the
 3 workers supplied by Union Pacific. On the contrary, it was *Union Pacific* that controlled wage
 4 payments to the workers, who were paid out of Union Pacific bank accounts to which only
 5 Union Pacific had access. Under controlling Ninth Circuit precedent, this fact alone is
 6 determinative and requires the Court to hold, as a matter of law, that Bravo is not the employer
 7 of the workers at issue.

8 As a general rule, it is the common law employer that is liable for withholding and
 9 paying over FICA and income taxes. *In re Sw. Rest. Sys.* (“*Southwest*”), 607 F.2d 1237, 1239
 10 (9th Cir. 1979). An important exception to this general rule applies, however, when “‘the person
 11 for whom the individual performs or performed the services does not have control of the
 12 payment of the wages for such services’” *Id.* (quoting 26 U.S.C. § 3401(d)(1)). In such
 13 circumstances, for purposes of the Internal Revenue Code provisions governing income tax
 14 withholding and FICA withholding, “the term ‘employer’ . . . means the person having control of
 15 the payment of such wages” *Id.*¹⁹

16 In *Southwest*, the wages of all employees in four separate corporations were paid from a
 17 payroll bank account maintained by the debtor. *Id.* at 1238. Notwithstanding that the debtor’s
 18 payroll bank account was occasionally funded by checks from the separate corporations, the
 19 Ninth Circuit held that because that the debtor—and the debtor alone—controlled the bank
 20 account, the debtor was the only employer for purposes of tax withholding. *Id.* at 1240
 21 (observing that “[n]o one other than the person who has control of the payment of the wages is in
 22 a position to make the proper accounting and payment to the United States”).

23
 24
 25
 26
 27 ¹⁹ Unlike Chapter 24 (governing income tax withholding), the definition of “employer” in Chapter 21 (governing
 28 FICA withholding) does not on its face contain the exception for a person who lacks control of the payment of
 wages. The Supreme Court, however, has held that Chapter 21 must be interpreted to contain the same exception as
 contained in Chapter 24. *Otte v. U.S.*, 419 U.S. 43, 51 (1974).

1 Similarly, in *Kittlaus v. United States*, 41 F.3d 327 (7th Cir. 1994), the Seventh Circuit
 2 found that a motel owner was not the employer of the motel employees for tax purposes because
 3 payment of employees was controlled by management company and the motel owner had limited
 4 access to payroll funds, and had no signature authority over the accounts used to pay the
 5 employees.

6
 7 Here, just like the motel owner in *Kittlaus*, Bravo had no signature authority—or any
 8 other authority—over the accounts used to pay the workers at issue. None of the workers in
 9 question received a Bravo paycheck or was paid from a Bravo bank account.²⁰ Rather, as will be
 10 testified to by Bravo’s construction manager and Rhodes’s CFO during the Relevant Period,
 11 Bravo hired Union Pacific as a subcontractor. *See also* Griffith Decl. at ¶ 4. Union Pacific, in
 12 turn, bore the responsibility at all times of paying the wages of the workers at issue. Bravo and
 13 Union Pacific maintained an arm’s length relationship, and accordingly, Bravo never had any
 14 type of access to or control over Union Pacific’s accounts. Thus, only Union Pacific retained the
 15 ability to pay its workers’ wages. The IRS has not—and cannot—provide any evidence to the
 16 contrary.²¹

17
 18
 19 **B. The Balance of the Common Law Factors Weighs in Favor of Finding that**
 20 **Union Pacific is the Employer of the Workers at Issue.**

21 As set forth above, the clear applicability of the exception in §3401(d)(1) for persons not
 22 in control of wage payments should end the inquiry as to whether Bravo is the employer for
 23 present purposes. However, even if the Court reaches the common law employment factors—

24
 25 ²⁰ In contrast, actual Bravo employees were all processed through Bravo’s payroll system and received Bravo
 26 paychecks. J. Garner Tr. at 13:1-11 (“Q: [H]ow did you know that [the Bravo employees] received paychecks? A:
 27 Because I would hand them out to them.”); Transcript of the Deposition of Pamela Garner, dated Jan. 18, 2012 (“P. Garner Tr.”), at 12:20-25 (describing individual employee listings in payroll system). A true and correct copy of
 excerpts from the Deposition of Pamela Garner is attached to the Bell Declaration as **Exhibit F**.

28 ²¹ As the Ninth Circuit’s decision in *Southwest* makes clear, the alleged facts that Union Pacific routinely invoiced
 Bravo, and Bravo remitted checks to Union Pacific, for the work performed by Union Pacific workers—even if
 proven true—have no bearing on the determination of who was the employer. 607 F.2d at 1240.

1 which it need not reach—application of those factors, on balance, also strongly favors the
2 conclusion that Bravo is not the employer of the workers at issue.

3 In addition to the payment of wages, courts consider several additional factors when
4 determining the existence of a common law employment relationship. Specifically, when
5 deciding which entity among more than one is the employer for tax purposes, courts have
6 considered, *inter alia*, which entity has the right and/or obligation to: (1) hire and fire the
7 individual employees; (2) control the individual employees; (3) provide the instrumentalities and
8 tools necessary for the employees' work; (4) assign additional projects to the individual
9 employees; and (5) provide employee benefits. *See Transp. Labor Contract/Leasing, Inc. v.*
10 *Comm'r*, 123 T.C. 154, 185 (2004), *reconsideration den.* T.C.M. 2005-173, Nos. 1188-01, 2005
11 WL 1649136 (U.S.T.C. July 14, 2005), *rev'd on other grounds*, 461 F.3d 1030 (8th Cir. 2006).²²

12 As the Reorganized Debtors will establish at trial, each of these factors weighs heavily in favor
13 of determining that Union Pacific, not Bravo, was the true employer of the workers. The IRS has
14 not proven otherwise.
15

16
17 1. Union Pacific was in Charge of Hiring and Firing the Workers.

18 In determining which entity among several is an individual's employer for tax
19 withholding purposes, courts consider which entity had sole and absolute authority to hire and
20 fire employees. *Transp. Labor Contract/Leasing, Inc.*, 123 T.C. at 189; *see also Blue Lake*
21 *Rancheria v. United States*, 653 F.3d 1112, 1120 (9th Cir. 2011). The Reorganized Debtors will
22 show that Bravo had no discretion—absolute or otherwise—to cause Union Pacific to hire (or
23 provide it with) specific laborers. On the contrary, Union Pacific had sole discretion with respect
24 to the ultimate hiring and firing of its employees. Griffith Tr. at 33:7-33:8.

25
26 Bravo likewise had its own longstanding hiring process. As part of this process, potential
27 Bravo employees would fill out applications and submit them directly to Bravo. P. Garner Tr. at
28

²² Factors of the common-law test which are inapplicable or of neutral effect have been omitted.

1 8:13-9:4. Those applications were subsequently reviewed by a Bravo foreman or construction
 2 manager. *Id.* at 9:1-4. The Reorganized Debtors will show that this hiring system was not
 3 utilized with respect to the workers at issue.

4 Additionally, though Bravo could decline to use a particular worker, it was unable to
 5 terminate any given worker's employment. *See Transp. Labor Contract/Leasing, Inc.*, 123 T.C.
 6 at 196 (noting the difference between the "right to decline using a particular driver-employee
 7 whom [the lessor] wanted to lease to it [and the right of] termination by [the lessor] of such
 8 driver-employee's employment"). The Reorganized Debtors will demonstrate that ultimate
 9 authority to terminate rested solely with Union Pacific, which strongly suggests that Union
 10 Pacific was the laborers' employer.

12 2. Union Pacific had the Right to Control the Workers' Activities.

13 When determining which of two entities is the employer, another factor courts consider is
 14 "which of the two [entities] has the right to control the activities of the individual." *Transp.*
 15 *Labor Contract/Leasing, Inc.*, 123 T.C. at 185 (internal citations omitted); *see also Nationwide*
 16 *Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992) (describing the common law test). The right to
 17 control the individual who performs the services includes the right to control: (1) the result to be
 18 accomplished by the worker; and (2) the details and means by which that result is accomplished.
 19 Treasury Regulations §31.3121(d)-1(c)(2). Industry-pertinent facts and circumstances help
 20 determine whether the employer has the right to direct and control the worker. *Clackamas*
 21 *Gastroenterology Assocs., P.C. v. Wells*, 538 U.S. 440 (2003).

23 The Reorganized Debtors will establish at trial that Bravo did not exhibit the requisite
 24 control over the workers in question and, thus, was not their true employer. The Reorganized
 25 Debtors will show, for instance, that the foremen in charge of the Union Pacific crews working
 26 on Bravo projects were in fact Union Pacific employees on Union Pacific's payroll. *See Griffith*
 27 *Tr.* at 37:19-21. Because foremen held sole control of their crews, this is evidence that both the
 28

1 results of the work done by Union Pacific and the means by which it was accomplished were
2 under the control of Union Pacific.

3 The Reorganized Debtors will also show that Union Pacific, not Bravo, was ultimately
4 responsible for choosing the workers that were sent to work on specific Bravo projects.
5 Consistent with this fact, upon completion of the work, the workers would return to Union
6 Pacific, *not* to Bravo, for their next assignments. *See* Transcript of the Deposition of Marlene
7 Marcus, dated Jan. 18, 2012 (“Marcus Tr.”) at 25:22-26:4²³.

8 Furthermore, the Reorganized Debtors will show that the Union Pacific crews routinely
9 were internally-directed and were not supervised by Bravo employees. For example, according
10 to the testimony of Sergio Juarez, an ex-foreman at Bravo, Mr. Juarez often arrived at certain
11 Bravo worksites long after the workers had completed their tasks and left for the day. Transcript
12 of the Deposition of Sergio Juarez, dated Jan. 17, 2012 (“Juarez Tr.”) at 39:17-23 (“I wouldn’t
13 see them all that often because, like I said, everything was what they called stage framing . . .
14 [s]ometimes I wouldn’t come until all these guys were gone[.]”)²⁴. Moreover, even to the extent
15 Mr. Juarez had control over the workers on his own crew, Mr. Juarez led only *Bravo* crews,
16 receiving Bravo paychecks (Juarez Tr. at 33:22-34:15), and was never in charge of a Union
17 Pacific crew. Union Pacific, as subcontractor, thus retained significant control over its workers,
18 including control over how they accomplished their tasks, even though the laborers were
19 working on Bravo projects. *See Transp. Labor Contract/Leasing, Inc.*, 123 T.C. at 188.

20 To the extent that Bravo did provide guidance to Union Pacific laborers, such guidance is
21 insufficient to give Bravo control over each laborer. *Id.* (holding that the fact that trucking
22 company gave routes, assignments, directions, etc. to leased truck drivers was not enough to give
23

24
25
26
27 ²³ A true and correct copy of excerpts from the Deposition of Marlene Marcus is attached to the Bell Declaration as
Exhibit G.

28 ²⁴ A true and correct copy of excerpts from the Deposition of Sergio Juarez is attached to the Bell Declaration as
Exhibit H.

1 it control over each driver). Given the nature of the labor performed, it would make little sense
2 for Bravo to provide no input. Indeed, the Reorganized Debtors will show that, though Bravo
3 may have provided certain project-specific guidance to the laborers from time to time, such
4 guidance was typical of the industry and does not support a finding that Bravo controlled the
5 workers at issue.

6 Finally, as further evidence of Union Pacific's control, the Reorganized Debtors will
7 establish that if a Union Pacific crew did not complete a Bravo project properly, it was Union
8 Pacific that was responsible for returning to undertake the necessary repairs or modifications.

9
10 3. Bravo did not Supply the Laborers with Tools to Complete their Tasks.

11 The supplying of tools necessary for the trade by an entity to an individual is further
12 suggestive of an employer-employee relationship. *See Transp. Labor Contract/Leasing, Inc.*,
13 123 T.C. at 185. The Reorganized Debtors will prove that here, Bravo did not supply any tools
14 to Union Pacific laborers. Indeed, as was common in the industry, Bravo did not supply tools to
15 its own employees. *J. Garner Tr.* at 33:17-21. Bravo employees, however, had the option of
16 participating in an employee tool purchasing program by which Bravo purchased certain tools on
17 their behalf. The costs of the tools would subsequently be deducted from the employees'
18 paychecks. This program could not have been made available to the workers at issue in this case
19 because they did not receive paychecks from Bravo from which the deductions could be made.
20 In fact, participation in the program by Union Pacific workers would have been an impossibility
21 as the workers were not compensated by Bravo and therefore received no Bravo paychecks from
22 which to deduct the cost of certain tools. This factor also weighs in favor of finding that Union
23 Pacific employed the workers that it provided to Bravo.

24
25
26 4. Union Pacific was the Only Entity Authorized to Assign Additional Work.

27 An entity's right to assign additional projects to an individual suggests the existence of an
28 employee relationship. *Transp. Labor Contract/Leasing, Inc.*, 123 T.C. at 190. As will be

1 demonstrated by the Reorganized Debtors at trial, Union Pacific determined which workers
2 would be assigned a given Bravo project. Upon completion of their tasks, the workers would
3 return to Union Pacific, not Bravo, for additional assignments. Moreover, the Reorganized
4 Debtors will show that Union Pacific had the right to subcontract laborers to *other* construction
5 companies even while they were still providing services to Bravo and the right to pull its workers
6 off Bravo projects at any time. This factor also demonstrates that Union Pacific, and not Bravo,
7 was the employer.

8
9 5. Union Pacific Provided the Workers' Employee Benefits.

10 The fact that an entity provides benefits to an employee weighs in favor of an
11 employment relationship. *Transp. Labor Contract/Leasing, Inc.*, 123 T.C. at 191. Here, as the
12 Reorganized Debtors will establish, Union Pacific was the only entity that provided any benefits
13 to the workers at issue. Pursuant to the Parties' agreement, Union Pacific was responsible for
14 providing workers' compensation and health insurance benefits. *See* J. Garner Tr. at 29:6-12 (Q:
15 . . . was there a reason given for the—having Mr. Kahre's company take over a portion of the
16 payroll? A: I would say the reason . . . was [sic] a lot to do with the insurance, and as far as—
17 yeah, I guess just the insurance.”). Insofar as Bravo's reasoning for hiring Union Pacific as a
18 subcontractor including Bravo's desire to increase its productivity without incurring the
19 significant insurance premiums associated with hiring additional laborers, this factor suggests
20 that Union Pacific is the employer of such laborers. *See Transp. Labor Contract/Leasing, Inc.*,
21 123 T.C. at 158 (“A principal advantage of leasing driver-employees from [the lessor] related to
22 [its] ability to obtain cost-effective workers' compensation insurance[.]”). Moreover, if a worker
23 on a Union Pacific crew was injured on the job, the Reorganized Debtors will show that it was
24 Union Pacific's responsibility to handle, not Bravo's. *See* J. Garner Tr. at 27:18-27:23. Thus,
25 Union Pacific's provision of benefits to the workers in dispute also weighs in favor of finding
26 that such workers were employees of Union Pacific, not Bravo.
27
28

1 Finally, as the evidence will show, some of the workers, who worked part-time for both
 2 companies, appeared on both Bravo's payroll and Union Pacific's payroll, which demonstrates
 3 that when such workers worked for Bravo, they were paid by Bravo, their taxes were withheld by
 4 Bravo, and their benefits were handled by Bravo.

5 Taken together, these factors tip the balance in favor of finding that Union Pacific was
 6 the employer responsible for the taxes claimed in the proof of claim. Against this evidence, the
 7 IRS's efforts to prove by clear and convincing evidence that Bravo was the employer must surely
 8 fail. The IRS cannot even establish the underpayment of taxes by Bravo by a preponderance of
 9 the evidence, much less the heightened standard of clear and convincing evidence.
 10

11 **IV. BRAVO IS NOT LIABLE FOR ANY PENALTIES.**

12 The IRS claims that Bravo is liable for penalties under 26 U.S.C. § 6651 (failure to pay),
 13 § 6656 (failure to deposit), and § 6663(a) (fraud). Bravo is not liable for any tax penalties, first
 14 and foremost, because liability for the penalties alleged is contingent on underpayment of the
 15 underlying taxes owed. *See* 26 U.S.C. §§ 6651, 6656, and 6663(a). For the reasons set forth
 16 above, Bravo owes no penalties because the IRS fails (1) to overcome the Reorganized Debtors'
 17 statute of limitations defense and (2) on the merits to establish Bravo's liability for the
 18 underlying taxes,.

19 Moreover, even assuming that the IRS could prevail on the merits of its underlying tax
 20 claim, the IRS cannot prevail on its claim for fraud penalties under § 6663(a). Pursuant to the
 21 plain language of the internal revenue code, the IRS bears the burden of proving by clear and
 22 convincing evidence that "the [taxpayer] has been guilty of fraud with intent to evade tax." 26
 23 U.S.C. § 7454. Here, as set forth above, the IRS has not even alleged—much less proved—any
 24 fraudulent intent on the part of Bravo to evade taxes.

25 **V. THE IRS GROSSLY MISCALCULATED THE INTEREST DUE.**

26 The IRS Claim lists \$1,295,746.08 of interest due on \$1,310,631.65 of tax. This amount
 27 of interest is grossly miscalculated. In particular, \$849,130.51 interest that the IRS calculates on
 28 \$431,179.11 unsecured general claim tax is grossly overstated. No appropriate calculation of

1 interest at the rates for the years at issue could have resulted in this amount of interest. It is over
2 double the amount of tax listed as due. Further, it does not match the calculations the IRS listed
3 in the IRS Claim for the unsecured priority claim portion.

4 **CONCLUSION**

5 For the foregoing reasons, the Debtors respectfully request that the Court declare that the
6 IRS Claim is disallowed and expunged as a matter of law.

7 Dated: February 13, 2012.

8
9 /s/ Shlomo S. Sherman

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